

**REPORT OF THE  
FINANCIAL EXAMINATION OF  
CAPE MUTUAL INSURANCE COMPANY**

**AS OF  
DECEMBER 31, 2007**

**FILED**  
APR 10 2009  
DIRECTOR OF INSURANCE,  
FINANCIAL INSTITUTIONS &  
PROFESSIONAL REGISTRATION



**STATE OF MISSOURI**

**DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS  
AND PROFESSIONAL REGISTRATION**

**JEFFERSON CITY, MISSOURI**

## TABLE OF CONTENTS

<u>Subject</u>	<u>Page</u>
SALUTATION	1
SCOPE OF EXAMINATION:	
Period Covered	1
Procedures	1
Comments - Previous Examination Report	2
HISTORY:	
General	2
Management	3
Conflict of Interest	4
Corporate Records	4
FIDELITY BOND AND OTHER INSURANCE	4
EMPLOYEE BENEFITS	5
INSURANCE PRODUCTS AND RELATED PRACTICES:	
Territory and Plan of Operation	5
Policy Forms & Underwriting	5
GROWTH AND LOSS EXPERIENCE OF THE COMPANY	6
REINSURANCE:	
General	6
Assumed	6
Ceded	7
SURPLUS NOTES	8
ACCOUNTS AND RECORDS	8
FINANCIAL STATEMENTS:	
Analysis of Assets	9
Liabilities, Surplus and Other Funds	10
Statement of Income	11
Capital and Surplus Account	11
NOTES TO THE FINANCIAL STATEMENTS	12
EXAMINATION CHANGES	12
GENERAL COMMENTS AND/OR RECOMMENDATIONS	12
SUBSEQUENT EVENTS	12
ACKNOWLEDGMENT, VERIFICATION AND SUPERVISION	13

February 9, 2009  
Liberal, Missouri

Honorable John M. Huff, Director  
Missouri Department of Insurance, Financial  
Institutions and Professional Registration  
301 West High Street, Room 530  
Jefferson City, Missouri 65101

Sir:

In accordance with your examination warrant, a full-scope examination has been made of the records, affairs and financial condition of

### **CAPE MUTUAL INSURANCE COMPANY**

hereinafter referred to as such, or as the "Company". The Company's administrative office is located at 120 South Main Street, Liberal, Missouri 64762, telephone number (417) 843-6265. This examination began on October 20, 2008, and was concluded on October 23, 2008, and is respectfully submitted.

### **SCOPE OF EXAMINATION**

#### **Period Covered**

The prior full-scope examination of the Company was made as of December 31, 2003, and was conducted by examiners from the State of Missouri. The current full-scope examination covers the period from January 1, 2004, through December 31, 2007, and was conducted by examiners from the Missouri Department of Insurance, Financial Institutions and Professional Registration (DIFP).

This examination also included material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

#### **Procedures**

This examination was conducted using the guidelines set forth in the Financial Examiners Handbook of the National Association of Insurance Commissioners (NAIC), except where practices, procedures and applicable regulations of the DIFP and statutes of the State of Missouri prevailed.

### **Comments-Previous Examination Report**

The comments, recommendations, and notes of the previous examination report dated December 31, 2003, are listed below followed by the Company's response and the current examination findings regarding such comments, recommendations and notes.

#### **Growth and Loss Experience of the Company**

*Comment:* It was recommended the Company review its underwriting procedures and expense structure, and implement necessary changes in an attempt to return the Company to profitability.

*Company Response:* The Company has reviewed and continues to monitor its pricing, commission rates, overhead expenses and growth of new business. Adjustments have been made in these areas in an attempt to return the Company to profitability.

*Current Findings:* The Company appears to have implemented the changes recommended in the previous examination.

#### **Reinsurance**

*Comment:* It was recommended the Company amend its casualty reinsurance agreement with Barton Mutual to reflect the current ceding commission rate.

*Company Response:* The Company amended the agreement to update the ceding commission rate.

*Current Findings:* The Company complied with the recommendations. Furthermore, the agreement was no longer in effect as of the current examination date.

## **HISTORY**

### **General**

The Company was organized on April 21, 1903, and operated under the name of Merchants' and Mechanics' Mutual Aid Society. In 1935, the Company was incorporated under the name Merchants' and Mechanics' Mutual Fire Insurance Company. On April 24, 1969, the Company changed its name to Cape Mutual Insurance Company. In 1997, the Company moved its home office from Cape Girardeau, Missouri to Liberal, Missouri.

The Company has a Certificate of Authority dated July 9, 1991, and is covered by Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Insurance Companies). The Company's

Certificate of Authority is renewed annually.

### **Management**

In accordance with the Articles of Incorporation, the annual meeting of the Company's members is held on the fourth Thursday in March at the home office of the Company or at such other place and time as may be designated. Special meetings of the members may be called by the Board of Directors at any time, and shall be called upon petition of one-fourth of the members. Eight members constitutes a quorum at any membership meeting. Proxy voting is permitted.

The management of the Company is vested in the Board of Directors, who are elected from the general membership. The Board of Directors consists of five members, serving staggered, five-year terms. All directors must be policyholders of the Company. The Board of Directors meets approximately every quarter, and the directors are compensated \$200 per each meeting attended.

Members serving on the Board of Directors as of December 31, 2007, were as follows:

<u>Name and Address</u>	<u>Occupation</u>	<u>Term</u>
Sally S. Fast 210 North Denton Liberal, Missouri	Insurance Executive	2003-2008
Fred M. Shaw 113 North College Liberal, Missouri	Insurance Executive	2007-2012
James L. Thurman Route 2 Box 94 Ava, Missouri	Retired	2005-2010
Thomas J. Shaw 302 Walser Liberal, Missouri	Insurance Executive	2004-2009
Dennis Wilson 759 North FF Highway Liberal, Missouri	Farmer/County Commissioner	2006-2011

The Board of Directors appoints for a term of one year, the officers of the Company. The officers of the Company serving at December 31, 2007, were as follows:

James L. Thurman	Chairman
Joel E. Dermott	President/Secretary/Treasurer
Thomas J. Shaw	Vice-President

### **Conflict of Interest**

The Company has written conflict of interest procedures for the disclosure of material conflicts of interest or affiliations by its directors and officers. The Company has its directors and officers sign conflict of interest statements on an annual basis. Noted disclosures included that all the directors serve at either a director or officer capacity in the related companies of Barton Mutual Insurance Company (Barton Mutual) and Gateway Mutual Insurance Company (Gateway Mutual). These relationships do not appear to negatively impact the Company's ongoing business operations.

### **Corporate Records**

A review was made of the Articles of Incorporation and the Bylaws of the Company. The Articles of Incorporation were not amended during the examination period.

The minutes of the membership and the Board of Directors' meetings were reviewed for the period under examination. The minutes and records of the Company appear to properly reflect corporate transactions and events.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company is a named insured on a fidelity bond, which also provides coverage to its related companies Barton Mutual and Gateway Mutual. The bond provides a limit of liability of \$500,000, with a \$20,000 per loss deductible. The fidelity bond coverage meets the minimum amount suggested in the guidelines promulgated by the NAIC.

The Company is a named insured, along with related parties Barton Mutual and Gateway Mutual, on a directors and officers liability policy with an aggregate limit of \$2,000,000 and a deductible of \$50,000 per claim.

The Company utilizes only independent agents, who are required to furnish documentation of errors and omissions insurance coverage.

The Company does not own any property and thus does not carry any property insurance. The Company is a named insured, along with Barton Mutual and Gateway Mutual, on a general liability policy.

The insurance coverage appears adequate.

## **EMPLOYEE BENEFITS**

The Company does not have any employees. Employee services are provided to the Company by Barton Mutual under an expense agreement. Barton Mutual provides essentially all services necessary for the operation of insurance business by Cape Mutual. In return for the services provided, Cape Mutual pays Barton Mutual 13.96% of direct premium, plus monthly rent of \$779 and monthly utilities of \$373. The Company has made adequate provisions for amounts payable to Barton Mutual for the expense agreement in the financial statements.

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operations**

The Company is licensed by the DIFP as an Extended Missouri Mutual Insurance Company operating under Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Insurance Companies). The Company is authorized to write fire, wind and liability insurance in all counties in the State of Missouri. The Company writes fire, wind and liability coverages. The Company's policies are sold by an independent agency force of over one thousand agents. Agents receive a 14% commission and are eligible for bonus commissions if certain loss ratio results are met.

### **Policy Forms and Underwriting Practices**

The Company utilizes AAIS and custom policy forms. The policies are renewed every three years. Property inspections and adjusting functions are performed by employees of Barton Mutual. Rates are determined by the Board of Directors. Renewal billings are mailed directly to the insured.

## GROWTH AND LOSS EXPERIENCE OF THE COMPANY

	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Gross Premiums</u>	<u>Gross Losses</u>	<u>Underwriting Income</u>	<u>Net Income</u>
2007	\$4,207,927	\$2,587,853	\$7,750,425	\$5,712,986	\$ (102,886)	\$ 181,717
2006	4,383,891	2,945,534	8,248,292	10,069,454	(310,143)	27,215
2005	5,107,728	3,946,586	8,317,899	3,251,484	121,249	496,380
2004	4,337,570	3,280,852	7,118,256	4,220,586	(198,542)	153,212

At year-end 2007, 9,952 policies were in force.

## REINSURANCE

### General

The Company's reinsurance premium activity on a direct-written, assumed and ceded basis for the period under examination is shown below:

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Direct	\$ 4,746,490	\$ 5,588,515	\$ 5,426,904	\$ 5,307,508
Assumed	2,371,766	2,729,384	2,821,388	2,442,917
Ceded	<u>(3,558,296)</u>	<u>(3,715,297)</u>	<u>(4,085,472)</u>	<u>(4,183,767)</u>
Net	<u>\$ 3,559,960</u>	<u>\$ 4,602,602</u>	<u>\$ 4,162,820</u>	<u>\$ 3,566,658</u>

### Assumed

Below is a summary of the Company's assumed reinsurance contracts as explained by the Company.

The Company participates in a reinsurance pool with MAMIC Mutual Insurance Company (MMIC). The agreement pertains to errors and omissions policies and director and officer liability policies written by MMIC. MMIC cedes 100% of the first \$1,000,000 each claim and in aggregate on all insurance agent and broker errors and omissions policies and 100% of the first \$2,000,000 each claim and in aggregate on all officer and director liability policies to the pool. MMIC receives a 35% ceding commission of net written premium ceded to the pool. The Company has a 3% share in the interests and liabilities of the pool.

The Company is a member of the Missouri Mutual Reinsurance Exchange (MMRE), which is a group reinsurance pool consisting of six Missouri mutual insurance companies and managed by



Guy Carpenter. Each pool participant is party to a memorandum of agreement, under which risk and premium assumptions are based proportionately on the risks ceded by each company to the pool. Overall pool participation for the Company in 2007 was approximately 25%.

The Company assumes property risks from Barton Mutual under an obligatory pro rata agreement. Under the agreement, the Company assumes premium and losses on a pro rata basis related to the next \$30,000 each risk in excess of Barton Mutual's combined retention and underlying reinsurance of \$115,000.

### **Ceded**

Below is a summary of the Company's ceded reinsurance contracts as explained by the Company.

The Company has several layers of reinsurance for its property risks. The Company retains the first \$30,000 per risk and cedes the remaining risks to its reinsurers on a pro rata basis.

The Company has a surplus pooling agreement with MMRE. Under the agreement, the Company cedes premium and losses on a pro rata basis related to the next \$30,000 per risk in excess of the Company's retention to MMRE. The Company receives a 35% ceding commission on premiums ceded under the agreement.

The Company has an obligatory pro rata reinsurance agreement with Barton Mutual. Under the agreement, the Company cedes on a pro rata basis the remaining premium and losses in excess of the Company's retention and underlying reinsurance layer, with a maximum cession of \$920,000 per policy. The Company receives a 35% ceding commission under the agreement.

The Company has an aggregate excess of loss reinsurance contract placed through Guy Carpenter with various reinsurers. Under the terms of the agreement, the reinsurers are liable for 95% of losses in excess of the greater of 65% of the Company's earned premium or \$2,080,000. Reinsurer liability is limited to 95% of \$5,000,000. Participating reinsurers included Arch Reinsurance Company (37.25%), QBE Reinsurance Corporation (27.00%), Aspen Insurance UK Limited (16.50%), The TOA Reinsurance Company of America (13.00%) and Employers Mutual Casualty Company (6.25%).

The Company has a casualty excess of loss reinsurance agreement placed through Guy Carpenter with various reinsurers that covers the Company's liability coverage exposures. Under the three layers of this contract, the reinsurers provide coverage limited to \$1,900,000 per occurrence in excess of the Company retention of \$100,000 per occurrence and an annual deductible of \$100,000. Participating reinsurers and respective percentages are identical to those outlined in the aggregate excess of loss agreement above.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that any assuming reinsurer should fail to

perform its obligations under its reinsurance agreement with the Company.

## **SURPLUS NOTES**

In 2004, the Company issued surplus notes totaling \$791,956, bearing annual interest rates of 3%. The notes were issued to Barton Mutual for \$391,956 and Gateway Mutual for \$400,000. In 2005, the DIFP approved and the Company made interest and principal payments totaling \$410,738 to settle the note and accrued interest with Barton Mutual. In 2005, the DIFP approved and the Company made interest payments totaling \$19,167 to Gateway Mutual.

In the 2007 Annual Statement, the Company reported surplus notes of \$400,000 outstanding to Gateway Mutual and an additional \$37,375 in accrued interest on the note as borrowed money. Interest on surplus notes should be reported in the surplus note balance until such time as the interest has been approved by the DIFP for payment and remains unpaid by the Company. It is recommended the Company report surplus note accrued interest that has not been approved for payment in the surplus note balance of future annual statements.

## **ACCOUNTS AND RECORDS**

The Company maintains its records on an accrual basis. The CPA firm of Van de Ven, LLC compiles the Company's financial statements and prepares the annual statement and tax filings.

## **FINANCIAL STATEMENTS**

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2007, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the Annual Statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the Financial Statements. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial, concerning their effect on the financial statements. Therefore, they were communicated to the Company and noted in the workpapers for each individual annual statement item.

**ANALYSIS OF ASSETS**  
**December 31, 2007**

Bonds	\$ 1,021,158
Cash on Deposit	2,080,401
Other Investments	98,328
Reinsurance Recoverable on Paid Losses	887,147
Interest Due & Accrued	16,664
Reinsurance Due & Assumed	104,229
	-----
Total Assets	<u><u>\$ 4,207,927</u></u>

**LIABILITIES, SURPLUS AND OTHER FUNDS**  
**December 31, 2007**

Losses Unpaid	\$ 380,657
Loss Adjusting Expense Unpaid	189,876
Ceded Reinsurance Premium Payable	239,473
Unearned Premium	1,598,667
Borrowed Money (Note 1)	0
Accounts Payable	44,374
Commissions Payable	99,126
Prepaid Policy Deposits	(1,695)
	-----
Total Liabilities	\$ 2,550,478
	-----
Guaranty Fund	\$ 761,142
Surplus Notes (Note 1)	687,375
Other Surplus	208,932
	-----
Total Surplus	1,657,449
	-----
Total Liabilities and Surplus	\$ 4,207,927
	=====

**STATEMENT OF INCOME**  
**For the Year Ending December 31, 2007**

Net Premiums Earned	\$ 3,807,657
Other Insurance Income	1,229,898
Net Losses & Loss Adjustment Expenses Incurred	(2,452,922)
Other Underwriting Expenses Incurred	(2,687,519)
	-----
Net Underwriting Income (Loss)	\$ (102,886)
Investment Income	80,140
Other Income	204,463
	-----
Gross Profit (Loss)	\$ 181,717
Federal Income Tax	(0)
	-----
Net Income (Loss)	\$ 181,717
	=====

**CAPITAL AND SURPLUS ACCOUNT**  
**December 31, 2007**

Policyholders' Surplus, December 31, 2006	\$ 1,438,357
Net Income (Loss)	181,717
Examination Change – Surplus Note Interest Reclassification	37,375
	-----
Policyholders' Surplus, December 31, 2007	\$ 1,657,449
	=====

## **NOTES TO THE FINANCIAL STATEMENTS**

### **Note 1 – Surplus Notes**

The Company improperly reported accrued interest on surplus notes as borrowed money in the liabilities section in the 2007 Annual Statement. Accrued interest that has not been approved for payment by the DIFP should be included in the surplus note component of surplus. To reflect this, an examination change was made to decrease the borrowed money account by \$37,375 and increase the surplus notes account by \$37,375.

### **EXAMINATION CHANGES**

As disclosed in Note 1 above, the only examination change was a reclassification of surplus note accrued interest from liabilities to surplus. The result was an increase to surplus and a corresponding decrease to liabilities of \$37,375.

### **GENERAL COMMENTS AND RECOMMENDATIONS**

#### **Surplus Notes (Page 8)**

It is recommended the Company report surplus note accrued interest that has not been approved for payment in the surplus note balance of future annual statements.

### **SUBSEQUENT EVENTS**

None.


## ACKNOWLEDGMENT

The assistance and cooperation extended by the employees of Cape Mutual Insurance Company during the course of this examination is hereby acknowledged and appreciated.

## VERIFICATION

State of Missouri    )  
                              ) ss  
County of Cole        )

I, Shannon W. Schmoeger on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only the facts appearing upon the books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

  
Shannon W. Schmoeger, CFE  
Financial Examiner  
Missouri DIFP

Sworn to and subscribed before me this 17<sup>th</sup> day of February, 2009.

My commission expires:


May 18 2012

  
Notary Public



## SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

  
Tim Tunks, CFE, CPA  
Examiner In Charge  
Missouri DIFP

April 3, 2009



Frederick G. Heese, Chief Financial Examiner  
Missouri Department of Insurance  
PO Box 690  
Jefferson City, MO 65102

RECEIVED  
APR 06 2009  
INSURANCE & SOLVENCY  
COMPANY REGULATION

RE: Cape Mutual Financial Exam

Dear Mr. Heese,

I am receipt of the Examination Report for Cape Mutual Insurance Company for the period ending December 31, 2007. In regards to the General Comments and Recommendations listed on page 12 of the report, I wish for the following response to be included in the final report.

Surplus Notes (Page 8)

The reclassification of the accrued interest on the surplus note from borrowed money in the liabilities section of the Annual Statement to the surplus note component of Company surplus has been duly noted and implemented on the 2008 Annual Statement as filed with the Department.

As a final note, we would like to extend our gratitude to Shannon Schmoeger for the professionalism demonstrated in conducting the financial exam of our company.

Sincerely,

A handwritten signature in cursive script, appearing to read 'Joel E. Dermott'.

Joel E. Dermott, President  
CAPE MUTUAL INSURANCE COMPANY

JED/me